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In the Supreme Court of the United States

OCTOBER TERM, 1957

FIDELITY-PHILADELPHIA TRUST COMPANY and ROBERT B. HAINES, III, EXECUTORS OF THE WILL OF MARY H. HAINES, DECEASED, *Petitioners*

v.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR THE RESPONDENT

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The purchase of a single-premium insurance policy and an accompanying non-refundable annuity contract was a single investment transaction whereby decedent reserved the income from her capital for life with the principal payable to her beneficiaries at death, and hence was a transfer of property includible in decedent's gross estate under 1939 Code Section 811(c)(1)(B)	9
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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the District Court (R. 13a-22a) is reported at 142 F. Supp. 561. The opinion of the Court of Appeals (R. 84-89) is reported at 241 F. 2d 690.

JURISDICTION

The judgment of the Court of Appeals was entered on February 28, 1957. (R. 90.) A timely petition for rehearing was denied on March 15, 1957. (R. 90-91.) The petition for a writ of certiorari was filed on May 17, 1957, and was granted on June 17, 1957. (R. 91.)

The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

In 1934, the decedent arranged to make contemporaneous purchases of three single-premium life insurance policies and three single-premium annuity contracts. The life insurance policies, which were issued without medical examination, would not have been issued to the decedent without the accompanying annuity contracts. The premiums for each life insurance policy and its accompanying annuity contract totalled approximately 11/10ths of the face amount of the life insurance policy. The decedent assigned two of the policies to her children and one to the trustee of a trust established by her. She received annuity payments under the contracts until her death.

The question is whether the death proceeds of the life insurance policies were includible in the decedent's gross estate under Section 811(c)(1)(B) of the Internal Revenue Code of 1939 as property transferred in which she retained the right to the income for her life or for a period which did not in fact end before her death.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 811. GROSS ESTATE.
>
> The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—
>
> * * *

(c) [as amended by Sec. 7 (a) of the Act of October 25, 1949, c. 720, 63 Stat. 891] *Transfers in Contemplation of, or Taking Effect at, Death*—

(1) *General Rule.*—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

* * *

(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; or

* * *

(26 U.S.C. 1952 ed., Sec. 811.)

STATEMENT

The District Court's findings (R. 3a-13a), which were based upon the pleadings and stipulations of the parties (R. 3a), may be summarized as follows:

In 1934, the decedent, then aged 76, purchased three single-premium life insurance policies aggregating $350,000 in face value: two from the Mutual Life Insurance Company of New York in the face amounts of $200,000 and $100,000, and one from the John Hancock Mutual Life Insurance Company in the face amount of $50,000. On the date of purchase of each insurance policy, the decedent also purchased single-premium, non-refundable annuity contracts from these

companies providing for annual annuities of $5,026, $2,440.64, and $1,295.56, respectively. The total premiums paid for the three insurance policies, together with the three accompanying annuity contracts, were $220,000, $110,000 and $54,000, respectively. (R. 4a-6a.) The life insurance policies were issued without medical examination, and they would not have been issued without the purchase of the annuity contracts; in fact, the companies required, in order to protect themselves in the event that the decedent died shortly after purchasing the policies, that the aggregate premiums for each life insurance policy and accompanying annuity contract should be 11/10ths of the face amount of the insurance policy.[1] (R. 6a, 11a-12a.) In each instance, the premium for the life insurance policy was fixed at regular insurance rates, and the balance of premium required to bring the total payment to 11/10ths of the face amount of the policy was determined by the company as the amount to be used to purchase an annuity contract (R. 11a-12a.)[2]

The decedent's four children were named primary beneficiaries of each insurance policy and Fidelity-Philadelphia Trust Company, as trustee under a trust established by decedent, was named contingent beneficiary of the share of any of decedent's children who predeceased her. (R. 6a-7a.) At the time of issuance

[1] Under this formula, the total premiums for the John Hancock policy and annuity contract should have been $55,000 instead of $54,000. This discrepancy is of no material significance to the issue.

[2] The District Court's general finding that the annuity contracts and payments were in no way dependent on the consideration paid for the contemporaneously issued insurance contracts (R. 5a) is to be read in conjunction with its specific findings relating to the interdependence of the contracts (R. 6a) and the method of computing and apportioning the aggregate premiums (R. 11a-12a).

of the two Mutual Life Insurance Company policies, all rights and benefits thereunder were assigned to decedent's children, to whom the dividends were paid. In 1934, the decedent assigned the John Hancock policy to Fidelity-Philadelphia Trust Company, as trustee; by an amendment to the trust agreement, dated July 6, 1938, this trust became irrevocable and the decedent retained no beneficial or reversionary interest in the trust. (R. 6a-9a.) In 1935, the decedent paid a gift tax on the transfer of the insurance policies. (R. 8a.) The policies provided for payment of designated cash surrender values, if they were surrendered. They were never in fact surrendered. (R. 9a-11a.)

The decedent died on May 7, 1946. The death proceeds of the three life insurance policies were not included in her gross estate in the estate tax return filed by her executors. The Commissioner determined a deficiency of approximately $97,000, plus interest, on the ground that the proceeds of the policies should have been included. (R. 3a-4a.) This deficiency was paid by the executors, and they subsequently filed a claim for refund which was denied. This action for refund followed. (R. 4a.) The District Court entered judgment for the taxpayers, holding that the insurance and annuity contracts were separate contracts, and that the decedent made no transfer which fell within the purview of Section 811(c)(1)(B) of the Internal Revenue Code of 1939, *supra*, pp. 2-3. (R. 13a-22a.)

The Court of Appeals reversed, holding that in substance, if not in form, the life insurance policies and annuity contracts were interdependent; that the transaction was almost identical to a transfer in trust with a life interest reserved to the settlor; and that the shifting of economic benefits on the death of the de-

cedent was akin to a testamentary disposition of the type taxable under Section 811(c)(1)(B) of the Internal Revenue Code of 1939. (R. 84-89.)

SUMMARY OF ARGUMENT

Section 811(c)(1)(B) of the Internal Revenue Code of 1939 requires, for estate tax purposes, inclusion in a decedent's gross estate of any property transferred *inter vivos* if the decedent retained a right to the income for life or for any period which did not in fact end before his death.

The decedent here, at an advanced age, purchased single-premium life insurance policies which were issued on condition that she also purchase single-premium, non-refundable annuity contracts. The premium for each insurance policy was charged at regular rates, but the premium for each annuity was fixed in such amount that, when added to the life insurance premium, the total equalled 11/10ths of the face amount of the insurance policy. Although the insurance policies and annuity contracts were separate in form, in substance they were interdependent. Each policy and each accompanying annuity contract jointly constituted a single investment transaction. This Court has previously held, in determining that such a transaction does not constitute true insurance, that the companion contracts must be considered together since the source of the "insurance" payment due on the death of the decedent is the total of the premiums paid on the two contracts. *Helvering* v. *LeGierse,* 312 U.S. 531. Each combined insurance-annuity transaction must be deemed as fully integrated as if it had been embodied in a single document.

Once it is recognized that the insurance policy and related annuity contract are integral parts of a single investment transaction, the substance and the tax effect of the arrangement become clear. The decedent invested a fund (aggregate premium) with the insurance companies and was entitled to receive a stipulated annual income therefrom (the "annuity" payments) for her life, with the principal (the "insurance" proceeds) payable to her beneficiaries at her death. The "insurance" paid at decedent's death to her beneficiaries represented nothing more than the principal amount of the premiums transferred to the insurance companies, while the "annuity" she received during her lifetime represented interest earned on that principal. Such an arrangement is the same, for all practical purposes, as a transfer in trust with income reserved to the settlor for life and the remainder payable to the beneficiaries, and is therefore a testamentary disposition falling within the purview of Section 811 (c)(1)(B). The fact that the insurance policies were assigned by the decedent during her lifetime does not affect either the unity or the essential nature of the transactions. A life tenant commonly has no ownership rights in the remainder which follows the life estate; nor is the statute aimed at a retention of such rights. It is the reservation of income for life from property which will come into possession of the beneficiaries upon the decedent's death which renders the property includible in the gross estate.

The fact that the decedent's assignees could have obtained a portion of the principal amount of the premiums transferred, by surrendering the insurance policies during her lifetime, is not significant. The insurance policies were never in fact surrendered, nor

was it intended that they should be. If the decedent had intended an immediately effective gift, she hardly would have made it in a form which would have required the taking of a substantial loss. Her manifest purpose was that her children should be paid the principal amount on her death, and that, in the meantime, she would receive a stipulated income for life. In any event, under the statute, the property is includible in the gross estate if the decedent retains the income for a period which does not in fact end before her death. The decedent did in fact retain the income for such period and the unexercised power of her assignees to surrender the policies does not alter either the realities or the tax effect of the transaction.

Taxpayers' argument rests entirely on the premise, rejected by this Court in *LeGierse*, that a single purchase of a combined insurance-annuity contract of the kind here involved is to be viewed for estate tax purposes as if it constituted two separate and unrelated investments. To subscribe to taxpayers' argument would exalt artifice above reality and open a wide avenue to estate tax avoidance. The congressional mandate in Section 811(c)(1)(B)—that property transferred with a life income retained must be treated as part of the transferor's taxable estate—could be readily circumvented simply by casting the transfer in the form of a premium payment for combination insurance-annuity contracts, under which income from the investment would inure to the benefit of the transferor during his lifetime by way of an "annuity", while the principal amount would be payable to the natural objects of his bounty upon his death by way of "insurance".

ARGUMENT

THE PURCHASE OF A SINGLE-PREMIUM INSURANCE POLICY AND AN ACCOMPANYING NON-REFUNDABLE ANNUITY CONTRACT WAS A SINGLE INVESTMENT TRANSACTION WHEREBY DECEDENT RESERVED THE INCOME FROM HER CAPITAL FOR LIFE WITH THE PRINCIPAL PAYABLE TO HER BENEFICIARIES AT DEATH, AND HENCE WAS A TRANSFER OF PROPERTY INCLUDIBLE IN DECEDENT'S GROSS ESTATE UNDER 1939 CODE SECTION 811(c)(1)(B)

Section 811(c)(1)(B), Internal Revenue Code of 1939, *supra*, p. 2,[3] requires that there be included in the gross estate of a decedent, subject to estate tax, the value of all property to the extent of any "interest therein of which the decedent has at any time made a transfer * * * by trust or otherwise * * * under which he has retained for his life * * * or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property * * *."[4]

The issue here is whether the decedent made transfers of the kind described in Section 811(c)(1)(B) when she purchased, in combination, single-premium, non-refundable annuity contracts and single-premium life insurance policies (the latter issued without medical examination and only on condition that the annuity

[3] As amended by Section 7(a), Act of October 25, 1949, c. 720, 63 Stat. 891. Section 7(b) of that Act made the provisions of Section 7(a) applicable to estates of decedents dying after February 10, 1939.

[4] In Section 2036 of the Internal Revenue Code of 1954 (26 U.S.C. 1952 ed., Supp. IV, Sec. 2036), this provision has been reenacted without substantial change. H. Rep. No. 1337, 83d Cong., 2d Sess., p. A314 S. Rep. No. 1622, 83d Cong., 2d Sess., p. 469.

contracts be purchased) pursuant to which she received stipulated annual payments for her life and her children received the principal amounts payable upon her death.[5]

The Court of Appeals, sustaining the Government's position, correctly held that the combined insurance-annuity contract purchase constituted a single investment, in which the decedent reserved the income to herself for life and gave her children the principal, payable at her death. Such transfers fall squarely within the language and scope of Section 811(c)(1)(B). *Conway* v. *Glenn*, 193 F. 2d 965 (C.A. 6th); *Burr* v. *Commissioner*, 156 F. 2d 871 (C.A. 2d), certiorari denied, 329 U.S. 785; *Estate of Reynolds* v. *Commissioner*, 45 B.T.A. 44. Cf. *Bank of New York* v. *Kelly*, 135 N.J. Eq. 418; *Day* v. *Walsh*, 132 Conn. 5 (decided under similar provisions of state tax laws). See, also, *In re Smiley's Estate*, 35 Wash. 2d 863, 868. Contra: *Bohnen* v. *Harrison*, 199 F. 2d 492 (C.A. 7th), affirmed by an equally divided Court, 345 U.S. 946.

A. The Insurance-Annuity Purchase Was a Single Investment Transaction

In determining the applicability of Section 811(c)(1)(B) to the facts of this case, inquiry must first be directed to the essential nature of the transaction between the decedent and the insurance companies. Al-

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[5] Since the issue is the same with respect to each of the transactions in which decedent purchased an insurance policy in conjunction with an annuity contract, this brief, for the sake of convenience, will frequently refer to the transactions as if there were one set rather than three.

though in form there was a separate life insurance policy and a separate annuity contract in each instance, in substance the insurance policy and the annuity contract were interdependent and formed integral parts of a single transaction. It is not accurate to assert, as taxpayers do, that the life insurance and annuity contracts are separate because separate in form or because the annuity contract could have been purchased without the life insurance. This assertion completely ignores the circumstance that the insurance policy, issued without medical examination, could not have been purchased without the contemporaneous purchase of the annuity contract at premiums calculated in such amount as to make the total premiums for the life insurance policy and its accompanying annuity contract equal to 11 10ths of the face amount of the insurance policy. (R. 11a-12a.) In fact, therefore, the insurance and annuity contracts were interdependent and their purchase in combination was a single investment with income reserved to the decedent for life and the principal payable to her children at her death.

This Court has determined, as a matter of law, that transactions of this type represent a single investment, rather than separate contracts of insurance and annuity, under the provisions of the predecessor of Section 811(g) of the 1939 Code. *Helvering* v. *LeGierse*, 312 U.S. 531; *Estate of Keller* v. *Commissioner*, 312 U.S. 543; *Tyler* v. *Helvering*, 312 U.S. 657. See Meisenholder, *Taxation of Annuity Contracts Under Estate and Inheritance Taxes*, 39 Mich. L. Rev. 856, 883-887 (1941). The same view has been adopted in the administration of state inheritance tax laws. *Bank*

of New York v. *Kelly*, 135 N.J. Eq. 418; *Day* v. *Walsh*, 132 Conn. 5; *In re Smiley's Estate*, 35 Wash. 2d 863. This principle was adopted as the underlying basis for the decisions in *Goldstone* v. *United States*, 325 U.S. 687, 690, and *United States* v. *Tonkin*, 150 F. 2d 531, 535 (C.A. 3d), certiorari denied, 326 U.S. 771.[6]

In *Helvering* v. *LeGierse*, *supra*, this Court concluded that the single-premium life insurance policy was not true "insurance" under Section 811(g) of the 1939 Code because there was no distribution of the risk of premature death among the policyholders. And that was so because the company, by requiring the contemporaneous purchase of a non-refundable annuity contract, always held a fund (consisting of the two premiums) at least equal to the face amount of the policy payable whenever death occurred. The Court stated (p. 542):

> Here the total consideration was prepaid and exceeded the face value of the "insurance" policy. The excess financed loading and other incidental charges. Any risk that the prepayment would earn less than the amount paid to respondent as an annuity was an investment risk similar to the risk assumed by a bank; it was not an insurance risk as explained above. * * *

Although the premiums in *LeGierse* were calculated separately and the company maintained separate re-

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[6] In *Goldstone*, the Court held that the insurance proceeds were includible in the decedent's gross estate under Section 811(c)(1)(C), because of a contingent reversionary interest, and accordingly deemed it unnecessary (p. 693) to decide whether they were alternatively includible under Section 811(c)(1)(B) by reason of the decedent's retention of the income during his lifetime.

serves[7] for each contract, as was done here, the Court looked to substance and concluded that the transactions could not be separated, stating (p. 540):

> The two contracts must be considered together. To say that they are distinct transactions is to ignore actuality, for it is conceded on all sides and was found as a fact by the Board of Tax Appeals that the "insurance" policy would not have been issued without the annuity contract. Failure, even studious failure, in one contract to refer to the other cannot be controlling. * * *

Obviously, as this Court recognized, the source of the payment required by the insurance policy at death was the combined premiums paid by the decedent. The annuity represented income earned by the investment consisting of the two premiums. This Court refused to permit the separate formal attributes of the insurance policy and the annuity contract to affect its conclusion, declaring (p. 541):

> Certainly the mere presence of the customary provisions does not create risk, and the fact that the policy could have been assigned is immaterial since, no matter who held the policy and the an-

[7] The existence of separate reserves, also present in this case (R. 9a), is of no legal significance. Contrary to the popular notion, the term "reserve" does not refer to the existence of any fund to pay liabilities of insurance companies. Rather, it refers simply to the liability of the insurance company on the policies issued discounted in accordance with mortality tables providing a fixed rate of interest. The insurance companies are merely required to have total assets on hand, without division, to meet total liabilities, including reserves. Statutory reserves are computed in the same manner. Mowbray and Blanchard, *Insurance, Its Theory and Practice in the United States* (4th ed.), pp. 357-358, 362-363, 371. In this case, in the two Mutual Life Insurance Company annuity contracts, the provision for computation of reserves at four per cent was eliminated. (Exs. D, E, R. 63, 65.)

nuity, the two contracts, relating to the life of the one to whom they were originally issued, still counteracted each other.

The contracts here in question are equally inseparable and without risk. The decedent, aged 76, was enabled to purchase life insurance in the face amount of $350,000, without medical examination, only upon condition that she purchase annuity contracts which were non-refundable no matter when she died. The combined premiums for these contracts totalled $384,000 and decedent was to receive a combined annuity of $8,762.20. (R. 4a-6a.) After deducting the loading charge of $34,000,[8] the decedent was entitled to receive, in the form of an "annuity", an income of approximately 2.5 per cent on the principal payable to her children at her death.[9] As this Court stated in

[8] The loading factor is the excess of the combined premiums over the face amount of the "insurance" payable at death and is designed to compensate the company for certain overhead expenses, like premium taxes and agents' commissions. *Helvering* v. *LeGierse*, *supra*; *Commissioner* v. *Keller's Estate*, 113 F. 2d 833, 835 (C.A. 3d), affirmed, 312 U.S. 543.

[9] "The explanation lies in the mathematical correspondence between annual interest and annuity payments. $100 due in ten years at 2% is precisely the same thing as an annuity certain of $2 for ten years combined with a promise to pay $100 without interest at the end of ten years. The discounted sums required to meet the annuity payments plus the discounted sum required to pay the $100 when due will always total $100, the amount of the loan. The same holds true if the loan is repayable at the death of the lender. * * * That being so, we can detect no substantial economic distinction between the conjoint effect of the two policies issued, and that of an engagement to repay Mrs. Keller, or her order, $20,000 upon her death, with interest at * * * 2% per annum * * * in the meantime. * * * The annuity * * * is not only a cog but also an indispensible cog in the economic machine which produced the amount received by the beneficiary." *Commissioner* v. *Keller's Estate*, 113 F. 2d 833, 834-835 (C.A. 3d), affirmed, 312 U.S. 543.

LeGierse, supra (p. 542), this was "an investment risk similar to the risk assumed by a bank". See, also, *Conway* v. *Glenn*, 193 F. 2d 965 (C.A. 6th); *Burr* v. *Commissioner*, 156 F. 2d 871 (C.A. 2d), certiorari denied, 329 U.S. 785; *Estate of Reynolds* v. *Commissioner*, 45 B.T.A. 44; *Bank of New York* v. *Kelly*, 135 N.J. Eq. 418; *Day* v. *Walsh*, 132 Conn. 5; Meisenholder, *Taxation of Annuity Contracts Under Estate and Inheritance Taxes*, 39 Mich. L. Rev. 856, 884 (1941). Nor is it realistic to assume that the decedent would have purchased the annuity contract alone, since under its provisions the annual payments ceased at her death and no part of the premium paid would have been refundable in the event that the decedent died immediately after purchasing such contract.[10]

Since the issuance of the life insurance policy was conditioned upon the purchase of the annuity contract (R. 6a), and since the extent of the investment in the annuity was tied to the amount of insurance purchased[11] (R. 11a-12a), it cannot be asserted that the contracts were independent. Such an argument, as the Court of Appeals stated (R. 88), "exalts form over

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[10] Moreover, the annuity contract read together with the insurance contract did not provide for "annuity" payments as that term is generally used and understood, since it entitled decedent merely to a return of interest on her investment and not of principal as well. An annuity "has as its basic function the systematic liquidation" of the principal. Huebner, *Life Insurance*, c. 1, pp. 154-155. "It is well known that an annuity is calculated to yield a recipient who lives out his expectancy a total amount equal to the consideration paid, plus interest thereon." Magill, *Taxable Income* (rev. ed. 1945), p. 433. See also *Igleheart* v. *Commissioner*, 174 F. 2d 605 (C.A. 7th); *Manne* v. *Commissioner*, 155 F. 2d 304, 307 (C.A. 8th).

[11] As noted above (*supra*, p. 4), each insurance policy was issued on the condition that an annuity be purchased in an amount sufficient to yield a combined premium equivalent to 11/10ths of the face value of the insurance policy.

substance in an arrangement where the Supreme Court has specifically directed that the form be ignored." The decedent, without medical examination, could not have given her children the right to receive $350,000 from the insurance companies at her death simply by paying the life insurance premiums aggregating some $314,000. The required annuity contracts, purchased pursuant to the 11/10ths formula (*supra*, p. 4), enabled the insurance companies effectively to neutralize the insurance risk and to assume the payment of the face amount of the policies at death. It was this nexus between the contracts which led this Court to conclude in *LeGierse*, *supra*, that the insurance and annuity contracts must be considered together as a single investment, although neither expressly refers to the other.

B. The Transaction Was Testamentary in Character Notwithstanding the Assignment of the Insurance Policy

Once the transaction in question is viewed as a single investment, as it must be (*Helvering* v. *LeGierse*, *supra*; *Goldstone* v. *United States*, *supra*), the conclusion seems inescapable that the transfer falls within the terms of Section 811(c)(1)(B) of the 1939 Code as a transfer of property in which decedent retained the income for life. As the Court of Appeals stated (R. 88):

> But for the insurance company's guarantee of the payments, it is identical to a transfer in trust with the settlor taking back a beneficial life interest. * * *

And see *Conway* v. *Glenn*, 193 F. 2d 965 (C.A. 6th); *Burr* v. *Commissioner*, 156 F. 2d 871 (C.A. 2d), certiorari denied, 329 U.S. 785; *Estate of Reynolds* v.

Commissioner, 45 B.T.A. 44; *Bank of New York* v. *Kelly*, 135 N.J. Eq. 418; *Day* v. *Walsh*, 132 Conn. 5.[12]

Viewed as a single investment, the effect of the transaction was that the decedent deposited a principal sum with the insurance companies in return for a guaranteed annual income of approximately 2.5 per cent of such sum and for a guaranteed payment of the principal to her beneficiaries at her death. The loading charge imposed over and above the principal amount was the cost to her of the guaranteed annual income and the guaranteed payment at her death, thus protecting her investment from the danger of shrinkage in value of the corpus. *Bank of New York* v. *Kelly*, *supra*, p. 421. The decedent, as the Court of Appeals noted, obtained something more than she could have secured by a transfer in trust with a reserved life interest; she was assured of a stipulated income and a fixed payment of principal to her beneficiaries at death.

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[12] "Payments tantamount to the income from the whole fund deposited were to go to her during her life." *Estate of Reynolds* v. *Commissioner*, *supra*, p. 50. "* * * the investment was analogous to a simple annuity with principal payable at death, a transfer which—even when irrevocable—is taxable under § 811(c)." *Burr* v. *Commissioner*, *supra*, p. 872. "The decedent transferred $110,000 of his assets to the insurance company and thereby obtained the contractual obligation of the company (1) to pay to him the stipulated income to be derived from the entire fund during his life, and (2) upon his death, to pay the fixed sum of the principal to his estate or to his designated beneficiaries. Intrinsically, the transaction is a transfer of the principal sum invested, coupled with a reservation for the benefit of the transferor, of a life interest. * * * Recognizing substance rather than form, the technical use of the two contracts did not disjoint the life interest from the remainder which ultimately was to become the *corpus* of the trust." *Bank of New York* v. *Kelly*, *supra*, p. 421. "The situation * * * approximates that of a trust with income payable to the settlor during his life and the principal payable to certain named persons at his death, * * *." *Day* v. *Walsh*, *supra*, p. 14.

If, instead of embodying these single transactions in separate documents, the decedent had provided in a single contract that she should invest $350,000, exclusive of loading charges, and should receive $8,762.20 annually for life and $350,000 should be payable to her beneficiaries at her death, it would be difficult to imagine a clearer case for the application of the provisions of Section 811(c)(1)(B).[13] A transfer in which the decedent reserves the income from the investment to herself for life, and in which her beneficiaries come into possession or enjoyment of the corpus at her death, is the precise type of testamentary disposition of property which Congress intended should be taxable as part of the estate. *Helvering* v. *Bullard*, 303 U.S. 297; *Hassett* v. *Welch*, 303 U.S. 303. See also *Commissioner* v. *Estate of Church*, 335 U.S. 632; Bittker, *Church and Spiegel: The Legislative Sequel*, 59 Yale L. J. 395 (1950).

The unity of the transaction is not altered by the fact that the decedent assigned the life insurance policy. As this Court pointed out in *Helvering* v. *LeGierse*, *supra*, 312 U.S. at 541, the fact that the policy could be assigned is "immaterial" since the insurance and the annuity contracts "still counteracted each other," no matter who held them. To similar effect, see *Conway* v. *Glenn*, 193 F. 2d 965 (C.A. 6th); *Burr* v. *Commissioner*, 156 F. 2d 871 (C.A. 2d), certi-

[13] The situation in the instant case is not essentially different from that in *Commissioner* v. *Clise*, 122 F. 2d 998 (C.A. 9th), certiorari denied, 315 U.S. 821, and *Mearkle's Estate* v. *Commissioner*, 129 F. 2d 386 (C.A. 3d), where the decedent had purchased, for a single premium, a joint and survivor annuity contract. In both those cases, it was held that the transfer resulted in a retained life income and that the value of the annuity payable to the survivor was includible in the gross estate of the decedent under the statutory provisions corresponding to Code Section 811(c)(1).

orari denied, 329 U.S. 785; *Estate of Reynolds* v. *Commissioner*, 45 B.T.A. 44; *Bank of New York* v. *Kelly*, 135 N.J. Eq. 418; *Day* v. *Walsh*, 132 Conn. 5. Cf. *Mearkle's Estate* v. *Commissioner*, 129 F. 2d 386 (C.A. 3d); *Commissioner* v. *Clise*, 122 F. 2d 998 (C.A. 9th), certiorari denied, 315 U.S. 821.

The assignment of the life insurance policies, which entitled the assignees to receive, at the decedent's death, the amount invested with the insurance companies, did not materially differ from any *inter vivos* transfer, in trust or otherwise, of a remainder interest which will come into possession upon the termination of the life estate. No matter how absolute the transfer of the remainder, the retention of a life interest in the income of the property is sufficient, under the statute, to render the remainder includible for taxation in the decedent's gross estate.[14] Cf. *Peck* v. *United States*, 38 F. Supp. 826 (E.D. Pa.). As the Court below stated it (R. 89):

> In a sense, a life tenant has no ownership right in the remainder. But possession of legal title to the life policy after the assignment is not controlling. All of Section 811(*c*) is plainly directed at inter vivos transfers where title is no longer in the decedent at death. * * *

Although this Court, in *Helvering* v. *LeGierse*, 312 U.S. 531, and *Goldstone* v. *United States*, 325 U.S. 687,

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[14] In *Helvering* v. *Bullard*, 303 U.S. 297, 302, and in *Commissioner* v. *Estate of Church*, 335 U.S. 632, 638, this Court repeated with approval the observation made in *Matter of Keeney*, 194 N.Y. 281, 287, affirmed, 222 U.S. 525, that—

> It is true that an ingenious mind may devise other means of avoiding an inheritance tax, but the one commonly used is a transfer with reservation of a life estate. * * *

determined that the life insurance policy and annuity contract must be regarded as parts of a single investment program, the Seventh Circuit, in *Bohnen* v. *Harrison*, 199 F. 2d 492, affirmed by an equally divided Court, 345 U.S. 946, held that the transaction was divisible, and that the assignment of the insurance policy operated to eliminate the death proceeds from the estate. In so holding, the Seventh Circuit ruled (199 F. 2d at 493) that the fact that the insurance policy would not have been issued without the annuity contract was "without legal significance". Yet, it was this factor which was relied upon in *LeGierse* and in the other cases dealing with combination insurance policies and annuity contracts as requiring a determination that the transaction represented a single investment. The decision in *Bohnen* v. *Harrison, supra*, represents, we believe, an erroneous interpretation of this Court's decisions. For, as stated in *LeGierse* (312 U.S. at 541), the fact that the policy could be assigned is immaterial since the insurance policy and annuity contract still counteract each other no matter who holds them.

The argument advanced by taxpayers leads to the anomalous result that the "insurance" proceeds in question are not includible in the decedent's estate *either* under Section 811(g), as "insurance", *or* under Section 811(c)(1)(B), as property transferred with the life income retained. It is hardly likely that Congress proposed that the same transaction should be treated as a single investment under one subsection (811(g)), but fragmented for the purpose of a cognate subsection (811(c)). Indeed, in the *LeGierse* case, this Court held (p. 542) that the transaction must be viewed as one for purposes of Section 811(c) as well

as Section 811(g). See, also, *Goldstone* v. *United States*, 325 U.S. at 690. Unless the proceeds of the insurance policies are includible in the gross estate under Section 811(c)(1)(B), they would escape estate tax entirely.[15]

C. The Possibility That the Assignees Might Have Surrendered the Policy for Its Cash Value is of no Significance

Taxpayers, throughout their brief, refer to the transaction undertaken by the decedent as a transfer of the cash surrender value of the insurance policy to the decedent's assignees, reasoning that the assignees could have obtained such surrender value at any time. There are at least two independently sufficient reasons why this factor is of no significance.

The first answer is rooted in the actual circumstances

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[15] It is significant that Section 404 of the Revenue Act of 1942, c. 619, 56 Stat. 798, effective with respect to estates of decedents dying thereafter, enlarged the scope of Section 811(g) of the 1939 Code by providing that where a decedent pays the premiums, after January 10, 1941, on a policy of life insurance on his own life, the full amount of the proceeds of the policy is includible in his gross estate even though the policy has been irrevocably assigned during his lifetime and even though the decedent has retained none of the incidents of ownership. H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 162-163 (1942-2 Cum. Bull. 372, 490-492); S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 234-236 (1942-2 Cum. Bull. 504, 676-677); H. Conference Rep. No. 2586, 77th Cong., 2d Sess., p. 69 (1942-2 Cum. Bull. 701, 725).

Section 811(g), however, is applicable only to amounts "receivable * * * as insurance" and *Helvering* v. *LeGierse*, *supra*, has determined that combination contracts of the type here involved are not insurance, but are taxable under the predecessor of Section 811(c). The result of the decision in *Bohnen* v. *Harrison*, *supra*, which held that, despite *LeGierse*, a separate contract of insurance is involved under Section 811(c)(1)(B), will be to permit such transfers to remain free from tax, under either subsection, in the period 1942-1949. Under that decision, therefore, a decedent purchasing insurance need only purchase an annuity contract as well to avoid estate tax.

of this case. The decedent's assignees never surrendered the insurance policies, but retained them until maturity and collected the full face amount of such policies. This was in accord with the manifest intention of the decedent. As has been noted, she paid a total of $384,000 in premiums for the insurance policies and annuity contracts in question. After deducting loading charges, the net investment was $350,000, the face amount of the policies. This was the sum which she intended to transfer to her assignees, as is apparent from the fact that she retained no interest in the principal sum, but a right to a fixed income therefrom at the rate of approximately 2.5 per cent.

The true nature of this type of transaction was accurately described in *Burr* v. *Commissioner*, 156 F. 2d 871 (C.A. 2d), certiorari denied, 329 U.S. 785, as follows (p. 872):

> When the decedent in this case transferred $107,500 to the insurance company, he obtained from it two promises: one to pay him a small rate of return in the form of monthly annuity payments, the other to transfer $100,000 to the named beneficiaries on his death. His annuity payments represented a fixed percentage of the total consideration; and the company's investment risk was so calculated as never to exceed the expected income from the premiums on the insurance and the annuities. * * *[16]

[16] Although the District Court found that dividends were paid to the assignees on two of the policies (R. 9a), there is nothing in the record to show what amount, if any, was so paid, and consequently nothing which would justify an allocation of the total death proceeds on the basis of a comparison of the dividends received by the assignees to the annuity received by the decedent. The burden of proving a basis on which such an allocation could fairly be made rested, of course, on taxpayer. *Interstate Transit Lines* v. *Commissioner*, 319 U.S. 590, 594.

It offends common sense to suppose that the decedent intended to transfer only the cash surrender values of the insurance policies. Immediately after issuance, the policies had a cash surrender value of $289,324 (R. 10a); on July 6, 1938, this value was $300,620 (R. 10a); and, immediately prior to the decedent's death, this value had increased to the sum of $326,249 (R. 11a). It is completely unrealistic to assume, as taxpayers do (Br. 9), that the decedent invested $384,000 to assure her beneficiaries of a cash surrender value of $289,324 in 1934, or $300,620 in 1938, or even $326,249 in 1946. If the decedent had intended to make an immediate gift of any of those amounts to her children, she would hardly have done so in such manner, nor would she have compelled her children to forego rights to a larger amount (the face value) in order to realize the "intended" gift. Viewing the transaction in its entirety, it is apparent that the decedent placed her money in an investment fund with the insurance companies in order to obtain a fixed income for her life with the principal to be paid to her children at her death. The transaction was aptly described in *Bank of New York* v. *Kelly*, 135 N.J. Eq. 418, as follows (pp. 422-423):

> In view of the conservative reason for the investment, it seems fantastic to suppose that a cancellation of the policy by Mrs. Parish during the lifetime of the insured at its surrender value was regarded by either as probable. If the decedent had intended to make a complete, absolute, and immediately effective gift, why would he resolve to invest a material portion of his estate in such a manner that an enjoyment of it by the donee before his death would necessitate the loss incident to the surrender of the policy. *Guggenheim* v. *Rasquin*, 312 U.S. 254, 257. Cash or securities

could well have been deposited in the trust instead of a single-premium life insurance policy payable upon the event of death and having a surrender value based on a mortality table.

Taxpayers state that the situation herein is analogous to the purchase by decedent of a government bond for $900, which attains its face value of $1,000 in twelve years by the accumulation of interest, and maintain that, if such a bond was given to a child of the decedent, the child could forego the $1,000 and cash the bond for $900. (Br. 15.) The illustration is singularly inapposite. The decedent in such case has expended only $900, and her donee is in a position to realize the full amount expended at once. With respect to the insurance policies here in question, on the other hand, the decedent's donees are not in a position to realize the full amount expended until the decedent's death. If the donees of the insurance policies had sought to reduce the policies to cash at once, the amount realized would have been substantially less than the amount just expended by the decedent to purchase the policies.

The fact that the donees, in the case of the bond, could realize the value of the gift immediately, while the donees of the insurance policies could not, serves only to highlight the crucial fact that the decedent did not intend to make an immediately effective gift. As is well recognized, the cash surrender value of a life insurance policy is scarcely the full measure of its worth. *Guggenheim* v. *Rasquin*, 312 U.S. 254. By adopting the medium that she did, the decedent clearly manifested her intention to transfer to her children the face amount of the insurance policies payable at her death while she retained the income for life.

Since the assignees could only obtain a lesser amount, *i.e.*, the cash surrender value of the policies, during the decedent's lifetime, and the larger amount was payable only upon her death, the transactions in question do not meet the test which this Court established in *Commissioner* v. *Estate of Church*, 335 U.S. 632, where it was stated (p. 646):

> In other words such a transfer must be immediate and out and out, and must be unaffected by whether grantor lives or dies. * * *

A second and complete answer is provided by the language of Section 811(c)(1)(B) of the 1939 Code. That section, in terms, applies not only to situations in which income from property has been retained for the life of the decedent, but also to situations where the income has been retained "for any period which does not in fact end before his death * * *." Section 811(c)(1)(B) thus looks to the facts actually existing at the time of death, not to what might have occurred during life. See *Goldstone* v. *United States*, 325 U.S. 687, 693. The same test was applied in taxing the decedent's interest in a joint tenancy under a predecessor of Section 811(e). *United State* v. *Jacobs*, 306 U.S. 363, 371.

Looking to the facts as they existed at decedent's death, it is conceded that the policy was not surrendered by her assignees during her life. Decedent continued to receive the income from her investment for her life and her children received the full sum payable on the policies at her death. The unexercised power of surrender "did not change the factual realities of the transaction." *Burr* v. *Commissioner*, 156 F. 2d 871, 872 (C.A. 2d), certiorari denied, 329 U.S. 785. The

present situation does not materially differ from that of a trust whereby the income is payable to the settlor for life and the remainderman is afforded the privilege, before the settlor's death, of withdrawing part of the principal in full satisfaction of his remainder interest. If the remainderman does not exercise his privilege, it is apparent that property is transferred at death on which income has been reserved to the decedent for life. Property transferred in such manner is plainly includible in the decedent's gross estate under Section 811(c)(1)(B).

Taxpayer's entire argument proceeds on the hypothesis, repudiated by this Court in *LeGierse* and *Goldstone*, that decedent's conjoined insurance-annuity purchase is to be treated as two separate and unrelated purchases, and that the total premium should be allocated as between the insurance and annuity features. What is more, taxpayers here would re-allocate even that portion of the total premium ascribed to the insurance contract, dividing it between the cash surrender value portion and the portion represented by the excess of face value over cash surrender value. There is no basis in fact or in law for any such segregation. The insurance proceeds paid at decedent's death represented nothing more nor less than repayment of the principal amount (single premium) invested by decedent with the insurance company for the combined insurance-annuity contract. The annuity which decedent received during her lifetime represented the interest on that investment. It follows that the entire amount of the investment, repaid at her death in the form of the insurance proceeds, constituted property transferred by the decedent during her lifetime but in which she "retained" for a "period

which [did] not in fact end before [her] death * * * the right to the income." Section 811(c)(1)(B).

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

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